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EX PARTE OR LATE FILED

July 19, 1996

EX PARTE

William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Dear Mr. Caton:

Re: *CC Docket Nos. 96-112, 96-46 and 94-1*

Today the attached letter was delivered to Chairman Hundt, Commissioner Chong, Commissioner Ness, Commissioner Quello, Kenneth M. Ackerman, Rick Chessen, Jim Coltharp, Joe Farrell, Dan Gonzalez, Meredith Jones, Regina Keeney, William Kennard, Kathleen Levitz, John Nakahata, A. Richard Metzger Jr., Kenneth P. Moran, Andrew Mulitz, James W. Olson, Gregory Rosston, and Anita Wallgren. Please associate this with the above referenced proceedings.

We are submitting two copies of this notice in accordance with Section 1.1206(a)(1) of the Commission's rules.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions.

Sincerely,



Attachments

cc: Chairman Hundt, Commissioner Chong, Commissioner Ness, Commissioner Quello, Kenneth M. Ackerman, Rick Chessen, Jim Coltharp, Joe Farrell, Dan Gonzalez, Meredith Jones, Regina Keeney, William Kennard, Kathleen Levitz, John Nakahata, A. Richard Metzger Jr., Kenneth P. Moran, Andrew Mulitz, James W. Olson, Gregory Rosston, Anita Wallgren, ITS

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

J. A. Gueidner
Vice President
Regulator

140 New Montgomery Street, Room 1814
San Francisco, California 94105
(415) 542-4916

PACIFIC BELL
A Pacific Telesis Company

July 19, 1996

Chairman Reed E. Hundt
Federal Communications Commission
1919 M Street N.W.
Room 814
Washington, D.C. 20554

Dear Chairman Hundt:

Re: CC Docket Nos. 94-1, 96-46 and 96-112

I write to oppose ill-advised changes proposed in the Notice of Proposed Rulemaking in CC Docket No. 96-112 (the "Notice") to segregate our regulated and nonregulated network costs.¹ The Commission plans to: 1) use a single fixed factor to allocate common costs of loop plant between regulated and nonregulated services, and 2) reduce our price cap rates accordingly by an exogenous cost adjustment. These actions would not only be arbitrary and capricious but also confiscatory of our investors' capital. They would chill the pace at which we could deploy video and other advanced services. Furthermore, as noted below, such steps directly conflict with previous Commission policy statements and Congress' goals in the 1996 Telecommunications Act to promote infrastructure development, encourage competition and eliminate unnecessary regulation.

If the Commission requires us to allocate 50% of our current loop costs to nonregulated services, as Paragraph 40 of the Notice suggests, we will be gravely harmed financially. If we must make this change on a "flash cut" basis, it will decrease our Common Line revenues by over \$400 million per year (this represents more than 25% of our total interstate revenues). Our stockholders will end up "holding the bag" since we are without an alternate source of recovery and cannot price our nonregulated services by regulatory fiat. Those services are subject to vigorous competition and we must price them based on market factors.

¹ See Notice of Proposed Rulemaking, In the Matter of Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket No. 96-112, (released May 10, 1996).

For the following reasons, the Commission is wrong in its belief that we can saddle ratepayers with a large portion of common costs used for both regulated and nonregulated activities. On January 1, 1991 we became subject to price cap regulation. At that time our rates were "capped" at our 1990-91 interstate cost levels. Thereafter, we were prohibited from increasing our rates to recoup any new infrastructure costs -- including our broadband deployment costs. Thus our shareholders -- not the ratepayers -- have funded all new infrastructure growth. Additionally, there are no cross subsidy concerns related to our embedded investment because we are required under the Part 61 and 64 rules to reduce our rates if we underforecast nonregulated usage of common plant. Given these realities, it is clearly improper -- and confiscatory -- for the Commission to further reduce our price cap rates to return economies of scope to the ratepayers.

Furthermore, the Commission is reviewing the LEC price cap and plans to adopt a total factor productivity (TFP) X-Factor for setting price cap rates.² An economically-based TFP X-Factor, like that proposed by USTA, will automatically return economies of scope from nonregulated services to the ratepayers. This will occur because USTA's TFP calculation includes all regulated and nonregulated revenues and costs for services that use common or joint facilities. If the Commission requires a further discrete rate reduction it will be a "double count."

Finally I am deeply concerned that the Commission is seriously considering scrapping the Part 64 rules in favor of a single arbitrary fixed factor to allocate loop costs among regulated and nonregulated services. This change is a wholesale reversal of the Commission's long-espoused position that wherever possible costs should be allocated based on cost causative principles. We will vigorously challenge any such changes.

Moreover, the Commission adopted the Part 64 rules after many years of analysis. These rules have repeatedly withstood scrutiny against claims of cross subsidy.³ Only recently, the Court reversed the Commission's decision to use an unsubstantiated non-cost causative approach to set interstate transport rates. It ordered the Commission to use a "cost-based alternative ... or to provide a reasoned explanation of why a departure from cost-based ratemaking is necessary and desirable ..."⁴

The Commission has no rational basis to reject a tried-and-true cost-based method in favor of an arbitrary approach. Adoption of one fixed factor for use by all LECs is even more questionable given that the LECs are deploying unique nonregulated services using discrete technologies in distinctly different demographic markets.

² See Report and Order, In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Para. 145, (released April 7, 1995).

³ See Appendix A.

⁴ See Competitive Telecommunications Ass'n v. FCC, No. 95-1168, slip op. at 19 (D.C. Cir., July 5, 1996).

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The changes the Commission contemplates will have severe financial consequences, stifle competition and discourage investment in new technologies. There is no basis for the Commission to adopt them given the abbreviated record and unwarranted end result. The Commission must retain its current cost allocation rules.

I would be pleased to meet with you to discuss any of the above issues.



John A. Gueldner

cc: Commissioner Chong, Commissioner Ness, and Commissioner Quello,
Kenneth M. Ackerman, Rick Chesson, Jim Coltharp, Joe Farrell, Dan Gonzalez,
Meredith Jones, Regina Keeney, William Kennard, Kathleen Levitz,
John Nakahata, A. Richard Metzger Jr., Kenneth P. Moran, Andrew Mulitz,
James W. Olson, Gregory Rosston, and Anita Wallgren

APPENDIX A

The Commission has repeatedly found that the Part 64 rules protect ratepayers against cross-subsidy.

Cite	Text
<i>Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 LEC Safeguards</i> , CC Docket No. 90-623, <i>Report and Order</i> , 6 FCC Rcd 7571, paras. 12-13 (1991) ("Computer III Remand Order")	"[W]e determine that our existing cost accounting safeguards . . . constitute a realistic and reliable alternative to structural separation to protect against cross-subsidy." Computer III Remand Order, para. 13.
<i>Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58</i> , CC Docket No. 87-266, <i>Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking</i> , 10 FCC Rcd 244, paras 156, 161, 166, 169, 179-182 (1994) ("VDT Recon. Order")	"We reject claims that we should amend Part 64 because current rules would not prevent LECs from improperly subsidizing video dialtone nonregulated services. To the contrary, we conclude that existing Part 64 rules do not require modification to prevent such an outcome." VDT Recon. Order, para. 179.
<i>Amendment of the Commission's Rules to Establish New Personal Communications Services</i> , CC Docket No. 90-314, <i>Second Report and Order</i> , 8 FCC Rcd 7700, para. 126 (1993) ("PCS Rules Order")	"While we recognize the concerns expressed about LEC participation in PCS, we also find that allowing LECs to participate in PCS may produce significant economies of scope between wireline and PCS networks. . . . In addition, we do not believe that commenters have justified imposing additional cost-accounting rules on LECs that provide PCS service." PCS Rules Order, para. 126.